Commission Meeting Minutes *amended*
May 8, 2014

Vice Chairman McDonough called the meeting to order at 12:10 PM. He announced that for the first time Chairman Domenic Russo is not in attendance as he is recovering from surgery. Vice Chair McDonough stated therefore, he would be acting as Chair for this meeting. He then reported that the Commission meeting is being tape recorded which will be noted in the minutes and that a stenographer is taking notes and asked that everyone state their names prior to speaking.

Commissioners Present: Chairman Gerald McDonough, Commissioners Philip Brown, John Langan, James Machado, Donald Marquis and Robert McCarthy. Chairman Russo was not in attendance, as noted above.

PERAC Staff Present: Executive Director Joseph Connarton, Deputy Executive Director Joseph Martin, General Counsel/Deputy Director John Parsons, Deputy General Counsel/Managing Attorney Judith Corrigan, Senior Associate General Counsel Ken Hill, Associate General Counsel Patrick Charles, Director of Strategic Planning Michael DeVito, Compliance Officer Thomas O'Donnell, Compliance Counsel Derek Moitoso, Chief Auditor Harold Chadwick, Director of Administrative Services Caroline Carcia, Chief Financial Officer Virginia Barrows, and Senior Executive Assistant Kim Boisvert.

Chairman McDonough welcomed the following guests: Anouk Dannan from Human Resources Division, Nick Favorito from the State Retirement Board, Sean Neilon from the Massachusetts Teachers' Retirement Board, Tom Gibson from the Belmont and Middlesex County Retirement Boards, Susan D'Amato and John Kelly from the Boston Retirement Board, Michael Sacco representing the Natick and Chicopee Retirement Boards, Kevin Blanchette from the Worcester Regional Retirement Board, Ronaldo Rausea-Ricupero and Leslie Hartford from Nixon Peabody, S. James Boumil representing Michael McLaughlin, Chip Greenberg from SEI, Scott Driscoll from NEPC, Frank Valeri from the Mass Retirees Association, Denis Devine from MACRS, Paul Shanley from Amity Insurance, and Carol Kusiuitz from Doris Wong Associates.

Chair McDonough offered a moment of silence for Firefighters Walsh and Kennedy both whom gave the ultimate sacrifice of their lives in the recent Boston fire. Commissioner McCarthy then offered a moment of silence for two (2) police officers, Maloney from Plymouth and Simmons from Boston, who also lost their lives in the line of duty recently.

Commissioner Brown made a motion to adopt the minutes of the April 10, 2014 meeting. Commissioner McCarthy seconded the motion and the minutes were adopted.

Investment Sub-Committee Meeting Update

Chairman McDonough, Chair of the Investment Sub-Committee, reported that the Sub-Committee met at PERAC on April 16, 2014 at which time the Sub-Committee considered the memorandum pertaining to the Fund to Funds (FOF) Manager process of selecting sub-advisors.

Chair McDonough stated that a new Draft Memorandum has been issued dated May 2, 2014 and explained the changes. He inquired if there were any questions.

Commissioner McCarthy inquired if the additional changes go beyond the registration with either the Securities Exchange Commission (SEC) or the Secretary of State (SOS) [the changes include such items as the compliance restrictions, selection of managers and the process]. Commissioner McCarthy also wants to have the responses from SEI and Attorney Sacco to be made part of the Commission record (enclosed).

Among those present, guests were given time to address the Commission.

Discussion ensued regarding PERAC going beyond the scope of its authority, vendor disclosures, progress made to date, the selection and principles of disclosure, statutory intent, fiduciary duty, the inability to comply with the policy as set forth, litigation regarding the final policy, testing the strategy, the fundamental issue with compliance of the proposed policy, and policy v. regulation.

The Commissioners gave some thoughts on the commentary and stated that it is very sad that there is not 100% transparency, protecting the retirees who cannot afford a scandal, Wall Street being similar to a pot of gold, registration with the SEC and/or SOS and the forms currently required to be filed, discussion of this issue for 18 months to almost 2 years, and PERAC meeting its statutory responsibility to regulate and issue policies according to the law.

Commissioner McCarthy made a motion to adopt the May 2, 2014 memo as presented. Commissioner Machado seconded the motion.

On the motion Commissioner McDonough wanted to provide a few comments. He stated that a regulation could actually tie our hands versus having a policy with an opportunity to work through some of these issues between PERAC and the boards. He then stated that just because we have adopted this policy the Commission may decide to move the policy through the regulation route. We have tried to be as responsive as we can. He then made it clear that some MOM/FOF managers that are comfortable with this structure as it exists at this time and it is the Commission's responsibility to issue a decision. The statement "Other structures will be assessed on a case by case basis to determine if these provisions are met." allows for some flexibility.

On the question the motion was unanimously adopted to approve and disseminate the May 2, 2014 memo as presented.

Chelsea Retirement Board – Michael McLaughlin

Chair McDonough reported that to accommodate the guests in the audience, he would adjust the Agenda and move the Chelsea Retirement Board – Michael McLaughlin issue up after a brief break at 1:05 PM. At 1:20 PM Chair McDonough stated that there are a few guests that have not been introduced earlier and asked them to introduce themselves.

The individuals stood and announced their names Joseph Siewko, Brian Monahan, Esq. and Carolyn Russo all representing the Chelsea Retirement Board.

Chair McDonough briefly reviewed the communications that have been received by PERAC since April 24, 2014 from Nixon Peabody representing the Chelsea Housing Authority regarding Michael McLaughlin, and S. James Boumil representing Michael McLaughlin. He further stated that the Commission is not prepared to take a vote at this time on this matter. However, he will make a motion to ask legal counsel to prepare an analysis and recommendations relative to the matters that are contained in all the communications.

Chair McDonough stated a number of items that he would like to be presented by PERAC legal staff to be discussed at the June Commission meeting regarding Section 15, McLaughlin retirement options and comments from all attorneys involved in this matter.

Mr. Connarton reported that the Legal Unit will prepare the analysis as requested for the Commission meeting being held in June. He also reported that PERAC had previously directed the Chelsea Retirement Board not to process Mr. McLaughlin's retirement application. Mr. McLaughlin has appealed that decision to DALA.

Commissioner Brown would like a procedural analysis what led up to this point (Chelsea's steps) and a road map to where we go from here.

Chair McDonough made a motion that PERAC legal staff prepare an analysis and recommendations relative to the McLaughlin matter, addressing the issues that have been raised here today and in documents that are submitted to PERAC. Each interested party shall have sufficient time from today to submit written comments to PERAC, at least a week prior to the June Commission meeting. Staff response shall be provided to the Commission for discussion and action, if any, and interested parties will be provided an opportunity to address the Commission prior to any action. Commissioner McCarthy made an amendment to the motion that any communication from PERAC also be provided to the interested attorneys. Commissioner Machado seconded the motion and amendment. On the question it was unanimously adopted.

Administrative Sub-Committee Meeting Update

Chair McDonough stated that Administrative Sub-Committee met at PERAC on April 25, 2014 at which time the Sub-Committee considered PERAC's FY 15 Proposed Budget. He stated that Chairman Russo, Chair of the Administrative Sub-Committee is not in attendance at this time and that he would report on his behalf. He stated that Mr. Connarton presented the proposed FY 15 budget and capital budget. He is requesting a 3.7% increase from FY 14 due to an increase in the fringe benefit costs, an increase in the property lease, contracts with outside vendors, and the increase in medical panel costs. He also proposes two (2) new positions and a 3.5% salary adjustment for staff.

Chairman Russo moved to accept the proposed FY 15 budget at the Sub-Committee and to forward to the full Commission for its discussion. The motion was seconded by Commissioner

McDonough. The motion was adopted by the Administrative Sub-Committee and has now been forwarded to the full Commission for it discussion.

Mr. Connarton reported that two new positions he proposes will bring PERAC staff back to staffing levels prior to 2008. One (1) position will support the Compliance Unit as a midrange position to assist with the investments, members, vendors, and the educational database analysis. The other position will support Caroline Carcia and Virginia Barrows to assist with vendor payroll, HRD payroll and the new computer systems implemented by the Commonwealth. He is also requesting a 3.5% salary adjustment for staff.

Commissioner Machado made a motion to accept the Administrative Sub-Committee's report and the proposed FY 15 budget as presented. Commissioner Langan seconded the motion and it was unanimously adopted.

Mr. Connarton thanked the Commission for its continued support. He also thanked Ms. Carcia and Ms. Barrows for their help in putting the budget together and the savings in expenses when possible.

Legislative Update

Mr. DeVito reported that the Senate is releasing its budget. He has not heard of any action on the expansion of PRIT, the OPEB bill or the Plymouth County Pension Obligation Bond bills. He continued that the House budget passed recently with language that would increase the board members on the PRIM board. Mr. DeVito then reported that Budget Amendment 849 creates a new type of retirement board and he will continue to monitor as the budget goes through the Senate.

Commissioner McCarthy inquired about the status of the Athol Retirement System.

Mr. Connarton stated that PERAC has a Temporary Order ready to issue if necessary. He then inquired if Mr. Blanchette of the Worcester Regional Retirement System had any updates for the Commission.

Mr. Blanchette reported that he has met with the Worcester Regional Advisory Council and several times with the Athol Retirement System to assist in a transition and is going back again to attend the town meeting. He stated that the Town consistently does not support the System. Athol has about $20 Million in assets with PRIT and has a small number of retirees.

Legal Update

Ms. Corrigan discussed the *Cambridge Retirement Board v. PERAC & Elizabeth Cadigan*, CR-12-574.

Mr. Parsons reported on the *Facey* case. Boston Detective Delores *Facey* has been the subject of an involuntary retirement proceeding and several articles in the Boston Globe. Mr. Parsons reported that the Globe article did not have the complete facts.

Chair McDonough discussed a DALA decision involving an Iraq war veteran and a police officer from Fall River, who suffered horribly. He continued that the Globe reports that there are 22 war veterans that commit suicide every day and 700 every month. Chair McDonough stated that this is a very sad case of PTSD which was never appealed to CRAB. He would like someone from PERAC to reach out and advise this gentleman of possible additional avenues available.

Mr. Moitoso stated that he has reached out to the person's attorney. The gentleman would not appeal this case due to his lack of money and his being so distraught about the legal system.

Chair McDonough again requested PERAC to reach out to this man.

Mr. Connarton stated that we would reach out to this man again.

Commissioner Machado stated that he would recuse himself in this matter.

Audit Update

Mr. Chadwick reported that audits are currently occurring at the Athol, Beverly, New Bedford, and State Retirement Boards. Internal reviews are being conducted at the Fall River, Franklin County, Plymouth, Salem, Teachers', and Webster Retirement Boards. He further noted that Everett Retirement Board responses are currently being reviewed and they are awaiting responses from the Chelsea and Plymouth County Retirement Boards. Mr. Chadwick told the Commission that the Cambridge, Northbridge, and Somerville Retirement Boards audit reports' have been posted on the PERAC Web Page since the last Commission meeting and explained their respective findings. Finally, he reported that no follow up audits have been completed this past month.

Legal Update Continuation

Ms. Corrigan presented the Larrson case which involves G.L. c. 32, § 12(1) and a possible benefit being paid out after the death of a member under both Option C and Section 9. She stated that PERAC has received 2 requests from retirement boards regarding whether the Commission's position has changed in the wake of Larrson. In one of these cases, the Board is asking that a regulation memorializing Larrson be adopted. Staff would like advice from the Commission on how to proceed.

Ms. Corrigan stated that the Commission could affirm its long standing position about the possible receipt of concurrent benefits on one member's account or it could adopt a new position in regard to this issue because of the Larrson case.

Discussion ensued to reach out for legislative clarification so the Commission can make a decision as to whether to adjust benefits or not. The Commission thanked Ms. Corrigan for a great presentation.

Chair McDonough complimented Ms. Corrigan on the article she wrote and published in the NAPPA Report dated April 2014 entitled "Cramming a Pension into a Suitcase: The Inapplicability of the Eighth Amendment to Pension Forfeitures".

Compliance Update

Mr. O'Donnell stated that the Compliance Unit has received over 1200 Vendor Disclosure Statements that include compensation paid and received. The deadline for filing was March 1, 2014 and at this point less than a dozen remain non-compliant. The next step is to analyze the reports.

Mr. Moitoso reported that the Statement of Financial Interests ("SFIs") must be filed by May 1 with exception of those members that must file with the State Ethics Commission and those are due June 1. He stated that PERAC is still missing some SFIs and that he needs to reach out to those individuals that have become inactive. He then explained that the board members are taking advantage of the educational opportunities made available and credits will be provided at the upcoming MACRS Conference.

Executive Director's Report

Mr. Connarton reported on staff activities since the last Commission meeting.

Mr. Connarton reminded those in attendance that the Emerging Issues Forum will be held on Thursday, September 18, 2014 at the College of the Holy Cross in Worcester, Massachusetts.

Mr. Connarton stated that the Athol Retirement Board and Chelsea/McLaughlin issue was discussed earlier.

Mr. Connarton stated that Philip Lemnios, the Town Manager of Hull, has written to the Commission as it pertains to the education credits needed according to the law. According to Mr. Lemnios, he is requesting a waiver from meeting the statutory requirements of the law.

Mr. O'Donnell explained the law, that retirement board members must meet a minimum of three (3) credits per year and a maximum of eighteen (18) credits for every term. Mr. Lemnios could finish out his term but is not eligible to be reappointed as he has zero (0) credits. Mr. Lemnios believes that his professional experience as town manager of 24 years should be taken into consideration for the education credits. Mr. O'Donnell asked the Commission how it would like staff to proceed.

After a brief discussion it was decided to invite Mr. Lemnios to the June Commission meeting to discuss further. Mr. Connarton will invite to Mr. Lemnios to the June Commission meeting.

Mr. Connarton then reported that there was an ECM conversion issue which has affected the 91A compliance issue. Due to this issue the Commission has given the retirees an additional 30 days for the 91A compliance and has notified the retirement boards.

Commissioners Langan, Machado, and McCarthy updated the Commission about the National Conference of Public Employees Retirement Systems ("NCPERS") Annual Conference that was held in Chicago, Illinois. Commissioner Machado brought all the documents that were distributed at the conference. He stated that the "pit falls and shareholders rights" was a very interesting topic to him. Commissioner Langan reported that he learned a lot and stated that he would highly recommend this conference to all. Commissioner McCarthy stated that he was reelected as a member of the Executive Board of the NCPERS and always finds this conference enlightening.

Commission Travel

Commissioner McCarthy made a motion to allow any of the Commissioners and staff to attend the 2014 NAPPA Conference being held in Nashville, Tennessee. Commissioner McDonough seconded the motion and the motion was adopted.

Other Business

Mr. Connarton stated that in the back of the Commission package is PERAC's response to an editorial in the Boston Globe presented by Iliya Atanasov from the Pioneer Institute entitled, "Pension Obligations need to be a Priority" dated April 28, 2014.

Commissioner McCarthy requested that Mr. Connarton reach out to Chairman Russo with the Commission's thoughts and prayers.

Mr. Connarton stated that Greg Mennis from PEW (formerly a PERAC Commissioner), would like to make a presentation to the Commission as it pertains to the "Stress Test of the Systems". He reported that he would ask Mr. Mennis if he would be available for the July Commission meeting.

Chair McDonough stated the next Commission meeting is scheduled for Thursday, June 12, 2014 at noon.

Commissioner McCarthy made a motion to adjourn. Commissioner Brown seconded the motion, and the motion was adopted. The meeting adjourned at 3:15 PM.

Commission Meeting Documents
Commission Agenda of the meeting for May 8, 2014
Commission Minutes for April 10, 2014

Investment Sub-Committee
Draft Memo re FOF/MOM, dated May 2, 2014

Administrative Sub-Committee
Proposed FY 2015 Budget

Legislative Update
Monthly Legislative Agenda and bullet points outlining legislation

Legal Update
Cambridge Retirement Board v. PERAC and Elizabeth Cadigan, CR-12-574
Globe article entitled *"Boston detective forced to retire 14 years after injury"*
Presentation to the Commission regarding the intersection of Option C and Section 9 in the wake of Larrson

Audit Update
Recent PERAC Audit Findings cover sheet and the respective audit findings

Executive Director's Report
Updated Staff Activities Memo
Globe article entitled *"McLaughlin can keep what he put into pension"*
Letter from S. James Boumil Esq. regarding Mr. McLaughlin Pension Matter, dated 4/15/14
Letter from Nixon Peabody regarding Chelsea Retirement Board Decision concerning Michael McLaughlin with attachments, dated 4/24/14
Chelsea Retirement Board's decision on the Michael McLaughlin Section 15 matter
Letter from Philip Lemnios, Board Member of the Hull Retirement Board concerning Education

Other Documents
PERAC's response to an editorial in the Globe regarding Pension Obligations
US News article entitled "Nonprofits Caught in Pension Crossfire Between Foundation, Unions"
NAPPA Newsletter dated April 2014, Volume 28, Number 1

Distributed at the Meeting
PERAC Pension Newsflash entitled "PERAC Minutes Now Posted on Website"
Letter from S. James Boumil, Esq. regarding Mr. McLaughlin Pension Matter, dated 5/7/14
Chapter 32, Section 15 Language

Approved:

Gerald McDonough, Acting Chairman
Public Employee Retirement
Administration Commission

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April 14, 2014

Gerald McDonough, Chairman
Investment Sub-Committee
Public Employee Retirement
Administration Commission
5 Middlesex Avenue, 3rd Floor
Somerville, Massachusetts 02145

Re: Proposed Guidelines on Manager of Manger / Fund of Funds Selection Process

Dear Mr. McDonough:

On behalf of our clients, the Chicopee Retirement Board and the Natick Retirement Board (respectively "Chicopee" and "Natick"), we wish to comment on and once again voice our opposition to the revised March 27, 2014 draft memorandum ("Draft Memorandum") which will be considered for adoption at the upcoming April 16, 2014 Investment Sub-Committee meeting and submission to the full Commission for its consideration at the May 8, 2014 meeting. Unfortunately, a prior commitment will not allow me to attend the April 16, 2014 Investment Sub-Committee meeting, however Chicopee and Natick would appreciate having this letter entered formally into the record and considered prior to any vote to forward the Draft Memorandum to the Commission.

So as not to tread over ground already plowed, we incorporate by reference our February 7, 2014 and March 7, 2014 letters previously submitted on behalf of Chicopee, and our concerns expressed therein from both a policy and legal perspective remain with respect to the most recent incarnation of the Draft Memorandum. Unfortunately, the most recent Draft Memorandum does little to alleviate those concerns; on the contrary, it appears the Investment Sub-Committee seems more entrenched than ever in recommending a policy to the Commission that despite its stated intent to "provide a framework that enables a retirement board to employ [a Manager-of-Manager ("MOM") or Fund-of-Funds ("FOF")] option when investing retirement systems assets," this policy not only exceeds the statutory authority that the Commission possesses, but it will in fact have the opposite effect of the stated intent and prevent retirement boards from utilizing a strategy that has paid handsome dividends to Chicopee and Natick in the past several years.

When we opened the Draft Memorandum provided electronically to us by the Investment Sub-Committee, we thought the wrong memorandum was attached as the substance of the first part of the Draft Memorandum spoke about the Opal Financial Group ("Opal") and its practices that supposedly have relevance to disclosures required by sub-advisors. In our view, any "relevance" of disclosures by sub-advisors must first begin with the analysis of whether the Commission has the authority to require any disclosure from a sub-advisor that has a contract with an investment manager. As we have stated before, there is no legal relationship between a retirement board and a sub-advisor and as such, the sub-advisor cannot represent that it will act "as Chapter 32 fiduciaries owing a duty to the [retirement board]." We would ask the attorneys on the Investment Sub Committee, and derivatively the Commission legal staff that advises the Investment Sub Committee, if you served as counsel to the sub-advisor would you advise your client to make a representation that it would act as a fiduciary to an entity with which your client has no contractual obligation or relationship? For the same reason, because no contractual relationship exists between a retirement board and the sub-advisor, the Commission need not be concerned regarding indemnification between the sub-advisor and the retirement board. Clearly, since there is no legal relationship that exists between a retirement board and a sub-advisor that is selected by the investment manager with which the retirement board has a contract, any attempt to regulate a sub-advisor in a mutual fund is well beyond the scope of the Commission's authority pursuant to M.G.L. c. 32, § 23(2)(c).

With the foregoing in mind, we were struck by the contrived connection between Opal and SEI under the guise of "relevance" to the MOM model. To the best of Chicopee's and Natick's knowledge, SEI has no connection to Opal, and it does not engage in the sort of "placement agent" practices as discussed in the Draft Memorandum. Is the Investment Sub-Committee suggesting that the selection process utilized by SEI to contract with sub-advisors for its family of mutual funds offered to Chicopee and Natick has a "pay to play" component? If the Investment Sub-Committee has any evidence of such a serious accusation, both Chicopee and Natick would be very interested in seeing that evidence. If no such evidence exists, then mentioning SEI in the same paragraph as Opal is reckless at best, and perhaps exposes some other motivation in attempting to connect SEI with Opal.

With respect to the Investment-Sub Committee's attempt to regulate – and it appears dictate – how a MOM Investment Manager selects its sub-advisors is a classic example of administrative overreach, and it ignores the rigorous oversight conducted by the Securities Exchange Commission ("SEC") relating to investment managers. As we understand the issues, oversight and fiduciary liability, the law governing sub-advisers is the same as the law governing investment advisers. When the term "investment adviser" is used in the Investment Company Act of 1940, as amended (the "Investment Company Act"), it also generally means any sub-adviser. There are two main legal bases for an investment adviser's fiduciary duty – common law and federal statutory law (Section 206 of the Investment Advisers Act and Section 36(a) of

the Investment Company Act related to advisers to mutual funds). A sub-adviser in a mutual fund has a fiduciary duty that runs to the fund and its shareholders. There are contractual obligations and liability provisions imposed upon sub-advisers by the adviser (SEI) of a mutual fund in the sub-adviser agreement between the adviser (SEI) and its sub-advisers.

SEI has fiduciary duties to the funds it manages, and as an adviser to its institutional clients (e.g., Chicopee, Natick, etc.) SEI also has a fiduciary duty to those clients directly in providing investment advisory and investment management services to those accounts/plans directly. Chicopee and Natick would have recourse against SEI for a breach of fiduciary duty by SEI in managing account/plan assets as well as have recourse against SEI for a breach of fiduciary duty by a sub-adviser in our mutual funds – both in SEI's role as investment manager to the account/plan and putting the plan in the mutual fund and as the Adviser to the mutual fund itself (in its role as fund adviser in overseeing the mutual fund sub-adviser). This legal construct not only minimizes Chicopee's and Natick's exposure, but also emphasizes the fiduciary duty and obligations SEI has to its clients.

Chicopee and Natick have been provided with the process employed by SEI in selecting its sub-advisors and it is stringent to say the least. More importantly, however, is that there is no language in Section 23B that even remotely suggests that the Commission has any regulatory authority with respect to the process by which an investment manager chooses its sub-advisors. As we have previously noted in prior communications, the word "Commission" only appears six (6) times – five (5) of which make reference to contractor/retirement board filing obligations, and the last one vests the authority in the Commission to file a civil action to enforce the provisions of section 23B(k)(8)(i). Clearly, the Legislature in enacting Section 23B sought to require that a retirement board follow a procurement process for the selection of investment managers and consultants, and each investment manager selected executes the appropriate disclosure forms and files them with the Commission, and executes a contract with a retirement board in conformance with Section 23B(k)(1). As noted above, SEI's activities, including its selections of its sub-advisors, fall squarely under the jurisdiction and supervision of the SEC – is the Investment Sub-Committee actually suggesting that it has the authority to infringe upon the province of the SEC? "State law, including municipal regulations, can be preempted by an act of Congress if the State law 'conflicts with federal law or would frustrate the federal scheme, or [if] the courts discern from the totality of the circumstances that Congress sought to occupy the field to the exclusion of the States.'" Arthur D. Little, Inc. v. Commissioner of Health & Hosps. of Cambridge, 395 Mass. 535, 548 (1985), quoting Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724, 747-748 (1985). There is no question that Congress sought to "occupy the field to exclusion of the States" by adopting the Investment Company Act, and thus any effort to regulate the activities of an investment manager beyond the Investment Company Act would undoubtedly exceed the Commission's authority.

Finally, we must once again object to the "solution" offered by the Investment Sub-Committee in

the event that a sub-advisor refused (or perhaps more accurately was unable for the reasons articulated in this letter) to file the disclosures with the Commission or make the representations to retirement boards as contemplated, the MOM could simply "not allocate assets of a Massachusetts retirement system to said fund or manager" connotes a fundamental misunderstanding of the mutual fund structure. A MOM such as SEI creates a family of funds in the varying asset classes, and within each fund are sub-advisors with complementary investment strategies to address market trends. SEI allocates the funds among the various sub-advisors as it seems appropriate, and SEI does not – nor does any MOM - have the ability to segregate retirement board funds and allocate them only to those sub-advisors (if any) who have agreed to the disclosures and representations required in the Draft Memorandum. Moreover, even if SEI could only give retirement board funds to the compliant sub-advisors, it would alter the carefully constructed diversification of the fund, and defeat the purpose of investing in the fund.

The fact that the Legislature permits retirement boards to invest with the Pension Reserves Investment Trust ("PRIT") fund as either a purchasing or participating system is a clear manifestation of statutory intent to permit a retirement board to invest in a MOM strategy. There is little if any distinction between what the PRIT fund and SEI does, and clearly if the Legislature has not deemed it necessary and appropriate to regulate how the PRIT fund operates, then clearly it did not intend to authorize the Commission to implement regulations that not only supersede state law, but also infringe upon the province of Congress to regulate and monitor the activities of investment managers. SEI has been extremely transparent with Chicopee and Natick, as well as complied with each and every provision of Section 23B. To impose further regulatory requirements on MOMs that exceed the Commission's limitations will not only effectively eliminate a sound and tested investment strategy from the marketplace, but also likely result in a judicial determination as to the parties duties and obligations pursuant to Section 23B. We would hope the Investment Sub-Committee would give some thoughtful deliberation before moving ahead with the Draft Memorandum, and rather than force this issue with a vote to forward it to the Commission for its consideration and possible implementation, we would hope that the conversation could continue at the Investment Sub-Committee level so that a mutual resolution could be reached that protects the interests of all parties.

We appreciate the continued opportunity to express our concerns and participate in this process. We look forward to finding a workable solution.

Very truly yours,

Michael Sacco

cc: Chicopee Retirement Board
Natick Retirement Board

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April 14, 2014

Gerald McDonough, Chairman
Investment Sub-Committee
Public Employee Retirement
Administration Commission
5 Middlesex Avenue, 3rd Floor
Somerville, Massachusetts 02145

Re: Proposed Guidelines on Manager of Managers / Fund of Funds Selection Process

Dear Mr. McDonough:

On behalf of our client, SEI Investments Company ("SEI"), we wish to comment on and voice SEI's opposition to the revised March 27, 2014 draft memorandum ("Draft Memorandum"), which will be considered for adoption at the upcoming April 16, 2014 Investment Sub-Committee meeting and submission to the full Public Employee Retirement Administration Commission (the "Commission") for its consideration at the May 8, 2014 meeting. We would appreciate having this letter entered formally into the record and considered prior to any vote to forward the Draft Memorandum to the Commission. In addition, representatives of SEI will be in attendance at the April 16, 2014 Investment Sub-Committee meeting.

Based on the Draft Memorandum, SEI maintains the veracity and proper application of its arguments as reflected in our firm's memorandum dated October 15, 2013 to Joseph Gallo of SEI (as attached), which outlines our views for concluding, among other things, that the interpretation of Section 23B of Chapter 32 of the Massachusetts statutes proposed by the Commission exceeds the Commission's authority under Section 23B and is in conflict with the plain language of the statute. We would also like noted for the record that SEI has no relationship with the Opal Financial Group.

We anticipate that the Investment Sub-Committee will further assess the Draft Memorandum prior to presenting the same to the Commission for its measured consideration based on all of the reasons we have communicated to the Sub-Committee.

Thank you for allowing us to participate in these discussions and to express our concerns regarding these important issues.

Very truly yours,

Sean Graber

cc: SEI Investments Company

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October 15, 2013

Joe Gallo
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Re: Interpretation of Massachusetts Advisory Services Procurement Statute

Dear Joe:

Thank you for your request that we review Section 23B of Chapter 32 of the Massachusetts statutes ("Section 23B")[1] and the interpretation of Section 23B proposed by the Commonwealth of Massachusetts Public Employee Retirement Administration Commission ("PERAC") as set forth in the letter dated September 19, 2013 from PERAC to SEI Investments and attachments thereto (the "PERAC Interpretation"). For your convenience, we set forth the specific issue and our conclusion below:

Issue 1: Whether the PERAC Interpretation as to be applied to the SEI Fiduciary Management Program is required by, or is consistent with, the plain language of Section 23B.

Short Conclusion 1: The PERAC Interpretation as to be applied to the SEI Fiduciary Management Program is not required by, and is not consistent with, the plain language of Section 23B.

Issue 2: Whether the PERAC Interpretation as to be applied to the SEI Fiduciary Management Program impermissibly imposes substantive regulation on registered investment companies and federally registered investment advisers.

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1 M.G.L. c. 32, Section 23B.

Short Conclusion 2: There are strong arguments that the PERAC Interpretation as to be applied to the SEI Fiduciary Management Program imposes substantive regulation on registered investment companies and federally registered investment advisers and is, therefore, invalid because of Federal preemption.

A more detailed discussion of the background, our analysis and our conclusion follows.

I. Background.

A. Section 23B.

Section 23B was enacted in 2011 in connection with adoption of broad reforms of the Massachusetts public pension systems. Section 23B falls into a category of state statutes generally known as "procurement regulations" that regulate the acquisition of goods and services by states, their agencies and instrumentalities. This purpose, namely to regulate acquisition of investment advice by Massachusetts municipal retirements boards ("Massachusetts Plans"), is clearly set forth in Section 23B(a), which states that the "section shall apply to every retirement board *contract* for the procurement of investment, actuarial, legal and accounting *services.*" (Italics added).

Section 23B(c) states the general requirement that a "retirement board shall enter into procurement *contracts* for investment . . . *services* . . . in accordance with this section." (Italics added). Section 23B(d) through 23B(k) then proceed to impose a number of substantive requirements that apply in connection with procurement of any covered contract, including a number of substantive requirements that apply specifically to contracts for procurement of investment advisory services.[2] Section 23B relies substantially on the use of defined terms, which are set forth in Section 23B(b). Among the significant definitions set forth in Section 23B(b) are the following (with italics added):

"Contract," an agreement for the procurement of *services*, regardless of what the parties may call the agreement.

"Contractor," a person having a *contract with a retirement board.*

"Services," the *furnishing of labor, time or effort* by a contractor, not involving the furnishing of a specific end product other than reports; provided, however, that the term shall not include employment agreements, collective bargaining agreements or grant agreements.

[2] A detailed discussion of the substantive requirements imposed under Section 23B is beyond the scope of this analysis.

B. SEI Fiduciary Management Program.

SEI Investments, through its various subsidiaries (together, "SEI"), is in the business of advising institutional investors, such as municipal retirement plans, pursuant to a program that SEI calls its "Fiduciary Management Program." SEI currently advises certain Massachusetts Plans as part of the Fiduciary Management Program and, in doing so, SEI provides a number of products and services. A typical Fiduciary Management Program engagement might involve all or some of the following:

1. SEI enters into an investment management agreement ("IMA") with the Massachusetts Plan, pursuant to which SEI agrees to provide asset allocation advice and to invest plan assets into a variety of investment products ("Advisory Services").[3]

2. SEI, pursuant to the IMA, causes the Massachusetts Plan assets to be invested, usually by the purchase of shares, into a variety of pooled investment products ("Investment Products"), including:[4]

    a. "SEI Funds," which are open-end and closed-end investment companies ("Registered Funds") that are registered under the Investment Company Act of 1940, as amended (the "1940 Act") and generally operate in a "Manager of Managers" structure:[5]

        i. Each SEI Fund has engaged SEI to act as investment adviser to the SEI Fund pursuant to an investment advisory agreement approved by the Board and shareholders of the SEI Fund in accordance with Section 15 of the 1940 Act.

        ii. With limited exceptions, SEI does not directly manage the assets of the SEI Funds. Rather, SEI engages one or more investment

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[3] The SEI affiliate in question, SEI Investments Management Corporation, is registered with the Securities and Exchange Commission ("SEC") as an investment adviser under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), and is a "qualified investment manager" as defined under 840 CMR 16.01 of the PERAC regulations.

[4] SEI may offer additional investment products that are structured differently than those Investment Products described herein. However, the Investment Products described in this section represent all but a small portion of the Investment Products that would be utilized for a Massachusetts Plan.

[5] Each SEI Fund is a separately organized legal entity or series of a separately organized entity, typically a Massachusetts business trust. The trusts operate under the oversight of an independent board of directors, as required under the 1940 Act.

sub-advisers who manage the allocated portion of the assets of the SEI Fund on a day to day basis. The sub-advisers are appointed only with Board approval in accordance with the 1940 Act and an exemptive order obtained from the Securities and Exchange Commission that exempts the hiring of sub-advisers from the shareholder approval requirement. This type of an arrangement is generally referred to as a "Manager of Managers" arrangement, because the primary manager (SEI) is responsible for supervising and recommending changes to sub-adviser relationships.

b. "SEI Fund of Funds," which are open-end and closed-end investment companies that are registered under the 1940 Act and generally operate in a "Fund of Funds" structure:

   i. Each SEI Fund of Funds has engaged SEI to act as investment adviser to the SEI Fund of Funds pursuant to an investment advisory agreement approved by the Board and shareholders of the SEI Fund of Funds in accordance with Section 15 of the 1940 Act.

   ii. SEI directly manages the assets of the SEI Fund of Funds. However, instead of investing the assets in portfolio securities (*e.g.*, stocks and bonds), SEI invests the assets of the SEI Fund of Funds into shares of the SEI Funds, which are structured as described above.

c. "SEI Collective Funds," which are trusts maintained by an SEI bank affiliate.[6]

   i. The Trustee of each SEI Collective Fund has engaged SEI to act as investment adviser to the SEI Collective Fund pursuant to an investment advisory agreement under the supervision of the Trustee.

   ii. Each SEI Collective Fund utilizes either a Manager of Managers investment program or a Fund of Funds investment program

[6] The SEI bank affiliate operates as a state-chartered trust company and the SEI Collective Funds are excluded from regulation under the 1940 Act pursuant to Section 3(c)(11) of the 1940 Act. The SEI bank affiliate also has established collective investment trusts where the bank affiliate has hired investment advisors other than SEI Investments Management Corporation. These collective investment trusts are not used in the SEI Fiduciary Management Program.

substantially identical to those used by the SEI Funds and the SEI Fund of Funds.

d. "SEI Funds of Hedge Funds," which are private funds organized as limited partnerships under Delaware law or under laws of the Cayman Islands.

i. Each SEI Fund of Hedge Fund has engaged SEI to act as investment adviser to the SEI Fund of Hedge Fund pursuant to an investment advisory agreement.

ii. Each SEI Fund of Hedge Funds utilizes a Fund of Funds investment program whereby SEI exercises investment discretion and causes the SEI Fund of Hedge Funds to invest in underlying hedge funds advised by unaffiliated managers.

C. The PERAC Interpretation.

In the PERAC Interpretation, PERAC states that it has observed "a trend towards the use of a 'Fund of Funds' structure whereby the retirement board would delegate the responsibility for portfolio construction and manager selection . . . ."[7] PERAC elaborated that "[c]onceptually, the 'fund of funds' manager is acting as an investment consultant with broader authority." PERAC does not clearly explain the basis for its conclusion, but then goes on to provide that "the 'fund of funds' manager must follow a process in selecting funds that parallels that set forth for retirement boards in Section 23B. Such a process is as follows: The 'fund of funds' manager shall solicit proposals through a request for proposals. The request for proposals shall [comply with Section 23B] . . . ." Through the PERAC Interpretation, therefore, PERAC has interpreted the requirements of Section 23B to treat a decision by an investment adviser who invests Massachusetts Plan assets into a fund (presumably a fund of funds or a manager of managers fund) as a procurement that is subject to Section 23B. In substance, this interpretation would subject decisions made within an SEI Investment Product to the requirements of Section 23B.

II. Discussion.

A. Massachusetts Statutory Authority.

In order to analyze the correct application of Section 23B to the suite of services and products typically provided by to a Massachusetts Plan pursuant to the Fiduciary Management Program, it

[7] We note that the PERAC Interpretation uses the terms "fund of funds" and "manager of managers" somewhat inconsistently and does not specifically define the terms. While these terms do not have specific legal definitions, we believe that some of the usage in the PERAC Interpretation is not consistent with general industry usage. Accordingly, except as otherwise noted, we will use the terms "Fund of Funds" and "Manager of Managers" as defined in this memorandum.

is necessary to examine each service or product separately. When interpreting Section 23B, consistent with Massachusetts law, we look at the plain language of Section 23B and ascribe to particular terms their plain meaning.[8] In addition, since Section 23B relies heavily on defined terms that were enacted as part of the statute, we look at the plain meaning of the specific definitions provided in the statute.

Advisory Services. As described above, the key feature of the Fiduciary Management Program is the suite of Advisory Services that SEI provides pursuant to the IMA. The IMA is a contract between SEI and the Massachusetts Plan that is governed by state law and the Advisers Act. The IMA calls for SEI to provide a stated suite of services in exchange for compensation, and includes other terms that are customary for investment adviser relationships. Taking into consideration the relationship of the parties and the terms of the IMA, we believe that the IMA calls for SEI to provide "services," that the IMA is a "contract" and that SEI is a "contractor" within the meaning of Section 23B. Accordingly, we believe that the substantive provisions of Section 23B would apply to the procurement of the IMA by a Massachusetts Plan.

Investment Products. As described above, participation in the Fiduciary Management Program involves SEI, pursuant to the IMA, causing a Massachusetts plan to invest in various Investment Products. When a Massachusetts Plan invests into an Investment Product, rather than entering into a contract for services, we believe that it purchases a security in a transaction that is governed by the federal securities laws. In particular, the Securities Act of 1933 regulates the offer and sale of securities of the SEI Funds and SEI Fund of Funds, and exempts from substantive regulation the offer and sale of securities of the SEI Collective Funds and SEI Funds of Hedge Funds.[9] In each case, the purchase entitles the holder to certain rights appurtenant to the security acquired, including an undivided interest in the underlying investment portfolio.

The relationship created does not appear to involve a furnishing of "services" to any investor, and there is no agreement for provision of services. While we are not aware of any Massachusetts authority on this point, we believe that a case arising under the Advisers Act is instructive. In Goldstein v. SEC, 451 F3d 873 (DC Cir. 2006) ("Goldstein"), the United States Court of Appeals for the District of Columbia considered an SEC rule that purported to treat investors in a private fund (*e.g.*, a hedge fund) as investment advisory clients of the private fund manager for certain purposes that could trigger a need for the fund manager to register with the

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[8] See M.G.L. c. 4, Section 6, clause Third. "It is a canon of statutory construction that 'statutory language should be given effect consistent with its plain meaning and in light of the aim of the Legislature unless to do so would achieve an illogical result.' " Welch v. Sudbury Youth Soccer Ass'n, Inc., 453 Mass. 352, 354-355 (2009), quoting Sullivan v. Brookline, 435 Mass. 353, 360 (2001). "While a court must normally follow the plain language of a statute, it need not adhere strictly to the statutory words if to do so would lead to an absurd result or contravene the clear intent of the Legislature." Commonwealth v. Rahim, 441 Mass. 273, 278 (2004).

[9] Notwithstanding that shares of the SEI Collective Funds are exempt from regulation under the 1933 Act by Section 3(a)(2) of that act, we believe that the exemption makes clear the conclusion that the transaction involves a securities offering.

SEC. In rejecting the SEC rule, the court distinguished the status of client, which typically has an arrangement for receipt of services, from an investor, who purchases an investment security:

> An investor in a private fund may benefit from the adviser's advice (or he may suffer from it) but he does not receive the advice *directly*. He invests a portion of his assets in the fund. The fund manager—the adviser—controls the disposition of the pool of capital in the fund. The adviser does not tell the *investor* how to spend his money; the investor made that decision when he invested in the fund. Having bought into the fund, the investor fades into the background; his role is completely passive. If the person or entity controlling the fund is not an "investment adviser" to each individual investor, then *a fortiori* each investor cannot be a "client" of that person or entity. These are just two sides of the same coin.[10]

In the instant case, the investing Massachusetts Plan does not acquire any direct relationship with the Investment Product, other than that of security holder. In addition, the Massachusetts Plan does not, by investing in an Investment Product, establish an advisory relationship with the Investment Product's investment adviser or subadviser. Accordingly, we believe that the sale of a security does not involve the provision of "services" or a "contract" within the meaning of Section 23B.

Similarly, we believe that the activities that are performed by the investment managers inside the Investment Product, whether SEI, a sub-adviser in a Manager of Managers arrangement, or an underlying fund manager in a Fund of Funds arrangement, are not performed pursuant to a contract that is subject to Section 23B. In each of these cases, the relevant investment adviser provides advice directly to an Investment Product, and the Investment Product is the client of the investment adviser. This advice is provided pursuant to an investment management agreement, which is entered into and approved by the Investment Product in accordance with applicable law, and is tailored to the needs of the Investment Product or underlying fund as a whole and not to the needs of any particular investor. While we are not aware of Massachusetts case law directly on point, the Goldstein case is again instructive:

> As recently as 1997, [the SEC] explained that a "client of an investment adviser typically is provided with individualized advice that is based on the client's financial situation and investment objectives. In contrast, the investment adviser of an investment company need not consider the individual needs of the company's shareholders when making investment decisions, and thus has no obligation to ensure that each security purchased for the company's portfolio is an appropriate investment for each shareholder." Status of Investment Advisory Programs Under the Investment Company Act of 1940, 62 Fed.Reg. 15,098,

[10] Goldstein at 880.

> 15,102 (Mar. 31, 1997). The Commission said much the same in 1985 when it promulgated a rule with respect to investment companies set up as limited partnerships rather than as corporations. The "client" for purposes of the fifteen-client rule of § 203(b)(3) is the limited partnership not the individual partners. *See* 17 C.F.R. § 275.203(b)(3)-1(a)(2). As the Commission wrote in proposing the rule, when "an adviser to an investment pool manages the assets of the pool on the basis of the investment objectives of the participants as a group, it appears appropriate to view the pool—rather than each participant—as a client of the adviser." *Safe Harbor Proposed Rule,* 50 Fed.Reg. at 8741.
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> The Supreme Court embraced a similar conception of the adviser-client relationship when it held in *Lowe v. SEC*, 472 U.S. 181, 105 S.Ct. 2557, 86 L.Ed.2d 130 (1985), that publishers of certain financial newsletters were not "investment advisers." *Id.* at 211, 105 S.Ct. 2557; *see* 15 U.S.C. § 80b-2(11)(D). After an extensive discussion of the legislative history of the Advisers Act, the Court held that existence of an advisory relationship depended largely on the character of the advice rendered. Persons engaged in the investment advisory profession "provide personalized advice attuned to a client's concerns." *Lowe*, 472 U.S. at 208, 105 S.Ct. 2557. "[F]iduciary, person-to-person relationships" were "characteristic" of the "investment adviser-client relationship[ ]." *Id.* at 210, 105 S.Ct. 2557. The Court thought it "significant" that the Advisers Act "repeatedly" referred to "clients," which signified to the Court "the kind of fiduciary relationship the Act was designed to regulate." *Id.* at 208 n. 54, 201 n. 45, 105 S.Ct. 2557. This type of direct relationship exists between the adviser and the fund, but not between the adviser and the investors in the fund. The adviser is concerned with the fund's performance, not with each investor's financial condition.[11]

Examining these relationships in the context of the plain language of Section 23B, it is clear that the procurement of services within the Investment Products or underlying funds is not within the scope of Section 23B's requirements. It is the case that the services provided by SEI or another investment adviser inside of an Investment Product is a "service" as defined in Section 23B, and is provided pursuant to a "contract" as defined in Section 23B. However, it is equally clear that those services and contracts are not within the scope of Section 23B's substantive requirements. This is because Section 23B(a) states that the Section applies only to a "retirement board contract" and Section 23B(c) provides that the requirements only will apply when a "retirement board shall enter into procurement contracts . . . ." None of the services performed in an Investment Product are pursuant to contracts that are with or for the benefit of a retirement board, and no retirement board has "entered into" such a contract. Accordingly, none of the

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11 Goldstein at 880-881.

Investment Product contracts are within the scope of Section 23B. Moreover, for the same reasons discussed by the Goldstein court, it would be inappropriate for PERAC to seek to expand the application of Section 23B to such contracts and such an interpretation would go beyond the plainly stated intent of the Massachusetts legislature.

B. Federal Preemption of State Regulation.

As discussed above, the plain language of Section 23B imposes restrictions on the ability of a Massachusetts Plan to procure investment services in a direct contractual relationship with an investment adviser. Section 23B does not purport to regulate substantively activities within an Investment Product, and we believe that the scope of Section 23B's plain language stops at the Investment Product. In contrast, compliance with the PERAC Interpretation as applied to Fund of Funds or Manager of Managers structures would impose substantive requirements on the process by which underlying funds and underlying investment advisers are selected and engaged in an Investment Product. For example, in order to comply with the PERAC Interpretation with respect to a Massachusetts Plan investment, engagement of a sub-adviser by an SEI Fund or selection of underlying funds in an SEI Fund of Funds would be subjected to the substantive procurement restrictions of Section 23B. While the argument is less clear with respect to an initial search being conducted by a Massachusetts Plan, an Investment Product which has a current Massachusetts Plan investor would be in the position of having either to comply with the substantive requirements of Section 23B on a forward looking basis or to cause the Massachusetts Plan to be redeemed out of, or to seek to withdraw from, the Investment Product.

In 1996, responding to significant differences among the state and Federal securities regulatory schemes, as well as disparate substantive regulation among the states, Congress enacted the National Securities Market Improvement Act of 1996 ("NSMIA").[12] Among other things, NSMIA codified Section 18 of the Securities Act of 1933 (the "Securities Act"), which precludes substantive regulation of "covered securities" by any state or any political subdivision of a state. Section 18(b)(2) defines covered security to include any security issued by a Registered Fund. In addition, NSMIA codified Section 203A of the Advisers Act, which precludes states from regulating the "registration, licensing, or qualification" of any SEC-registered investment adviser.[13]

The PERAC Interpretation could be viewed as imposing substantive regulation on Investment Products, including Registered Funds, and on SEC-registered investment advisers. If viewed as a substantive regulation of the operations of a Registered Fund or an SEC-registered investment

[12] See Report on the Uniformity of State Regulatory Requirements for Offerings of Securities That Are Not "Covered Securities" (http://www.sec.gov/news/studies/uniformy.htm).

[13] See Section 203A(b)(1) of the Advisers Act.

adviser, then the PERAC Interpretation would be invalid because state substantive regulation of Registered Funds and SEC-registered investment advisers has been preempted by Federal law.

III. Conclusion.

While not entirely free from doubt, we believe that if the issue is properly presented, a court should conclude that the PERAC Interpretation as proposed to be applied to the SEI Fiduciary Management Program goes beyond the plain language of, and is inconsistent with, Section 23B. We also believe that strong arguments can be made that the PERAC Interpretation should be viewed as imposing substantive regulation on Registered Funds and, if determined to impose substantive regulation, the PERAC Interpretation would be invalid because of Federal preemption.

This letter expresses our views only as to issues arising under Section 23B in effect as of the date hereof. It represents our best legal judgment as to the matters addressed herein, but is not binding on the courts or any other person. Accordingly, no assurance can be given that the opinions and analysis expressed herein, if contested, would be sustained. The authorities upon which we rely are subject to change either prospectively or retroactively, and any change in such authorities or variation or difference in the facts from those on which, with your permission, we rely and assume as correct, as set forth above, might affect the conclusions stated herein. This letter addresses only the specific matters discussed herein and does not address any other matters. By delivering this advice, we undertake no obligation to advise you of any new developments in the application or interpretation of the applicable laws or the effect of any such developments on our advice.

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Very truly yours,

Timothy W. Levin

TWL
Attachment